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NORTHERN DISTRICT OF CALIFORNIA

1 HELANE L. MORRISON (State Bar No. 127752)
2 ROBERT L. MITCHELL (State Bar No. 161354)
2 MICHAEL S. DICKE (State Bar No. 158157)
3 CRAIG M. HUGHES (State Bar No. 114970)

4 Attorneys for Plaintiff
5 SECURITIES AND EXCHANGE COMMISSION
6 44 Montgomery Street, Suite 2600
7 San Francisco, California 94104
8 Telephone: (415) 705-2500
9 Facsimile: (415) 705-2501

E-filing

10

11 UNITED STATES DISTRICT COURT
12 NORTHERN DISTRICT OF CALIFORNIA

13 SAN FRANCISCO DIVISION

14 SECURITIES AND EXCHANGE COMMISSION

Case No.

15 **C 04 4120 E-filing**

16 Plaintiff,

17 vs.

18 DONALD M. FITZPATRICK AND THOMAS R.
19 STITT,

20 Defendants.

21 COMPLAINT FOR PERMANENT
22 INJUNCTION AND OTHER LEGAL AND
23 EQUITABLE RELIEF

24 DEMAND FOR JURY TRIAL

25

26 Plaintiff Securities and Exchange Commission (the "Commission") alleges:

27 **SUMMARY OF THE ACTION**

28 1. This matter involves financial reporting fraud by former executives of Liberate
29 Technologies ("Liberate" or the "Company"), a San Carlos, California software manufacturer.
The fraud, which ran from at least November 2001 to September 2002, was carried out by Donald
M. Fitzpatrick ("Fitzpatrick"), who was then Liberate's head of sales and Chief Operating
Officer, and Thomas R. Stitt ("Stitt"), then a regional sales Vice President.

1. Fitzpatrick and Stitt fraudulently inflated Liberate's reported revenue in several ways.
In one instance, defendants secretly funneled Liberate funds to a customer, to enable that
customer to pay for a software license from Liberate (a so-called "round-trip sale"). In another,
defendants misled Liberate finance personnel about the amount of work remaining on a

1 development project, which caused the Company to recognize revenue prematurely. Fitzpatrick
 2 also caused Liberate to recognize revenue improperly upon shipment of a product that he knew
 3 was inadequate to meet a customer's needs. And in another instance, Fitzpatrick granted a
 4 customer price concessions that substantially reduced the revenue that Liberate would realize on a
 5 contract, without disclosing the concessions to Liberate finance personnel.

6 3. In furtherance of the fraud, defendants repeatedly misrepresented or withheld
 7 information about key elements of the transactions from Liberate finance personnel responsible
 8 for revenue recognition and from the Company's independent auditors. As a result of defendants'
 9 fraud, Liberate materially overstated its revenue in filings with the Commission and press releases
 10 for the second and third quarters of its fiscal year 2002 and for that entire year, and also for the
 11 first quarter of its fiscal year 2003.

12 4. The Commission seeks a court order barring Fitzpatrick and Stitt from serving as
 13 officers and directors of any public company; ordering them to disgorge all benefits received as a
 14 result of their violations of the securities laws; imposing civil monetary penalties; and enjoining
 15 them from future securities laws violations.

16 **JURISDICTION, VENUE AND INTRADISTRICT ASSIGNMENT**

17 5. The Commission brings this action pursuant to Sections 20(b) and 20(c) of the
 18 Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77t(b) and 77t(c)] and Sections 21(d) and
 19 21(e) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. §§ 78u(d) and
 20 78u(e)].

21 6. This court has jurisdiction over this action pursuant to Sections 20(c) and 22(a) of the
 22 Securities Act [15 U.S.C. §§ 77t(c) and 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. §
 23 78aa]. Fitzpatrick and Stitt, directly or indirectly, have made use of the means and
 24 instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities
 25 exchange in connection with the acts, practices and courses of business alleged in this Complaint.

26 7. Venue is proper in this District pursuant to Section 27 of the Exchange Act [15 U.S.C.
 27 § 78aa]. One of the defendants resides and transacts business in, and a substantial part of the acts
 28 or transactions constituting the violations occurred in, the Northern District of California.

8. Assignment to the San Francisco Division is appropriate pursuant to Civil Local Rules 3-2(c) and 3-2(d) because a substantial part of the acts and omissions giving rise to the Commission's claims occurred in San Mateo County, California.

DEFENDANTS

9. Fitzpatrick, age 48, resides in or near Sydney, Australia. At the time of the events alleged in this Complaint, he resided in Palo Alto, California. Fitzpatrick was Liberate's Vice President of Sales and Professional Services from January 2000 until June 2002, when he was promoted to Chief Operating Officer ("COO"), a position he held until November 2002. Liberate terminated Fitzpatrick's employment for cause in December 2002.

10. Stitt, age 50, resides in Redwood City, California. He was Liberate's Vice President of Sales for the Asia and Pacific Region from the summer of 2001 until the Company terminated his employment for cause in January 2003.

RELEVANT ENTITY

11. Liberate is a software manufacturing company with its principal place of business in San Carlos, California. The Company sells software and services for large cable and telecommunications networks. At the time of the events alleged in this Complaint, Liberate's common stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act [15 U.S.C. § 78l(g)] and traded on the Nasdaq Stock Market.

FACTUAL ALLEGATIONS

12. During the course of its fiscal year 2002, which ended May 31, 2002, Liberate found it increasingly difficult to generate revenue to meet the quarterly expectations it had announced to the public. In an effort to reach the Company's quarterly revenue goals, Fitzpatrick and Stitt caused Liberate to recognize revenue fraudulently on a number of transactions. As part of the fraud, Fitzpatrick and Stitt (who reported directly to Fitzpatrick) repeatedly misrepresented or withheld material facts about the transactions from Liberate's finance personnel and its independent auditors.

1 **I. Defendants' Fraudulent Conduct**

2 **A. Fitzpatrick Caused Liberate to Recognize Revenue Improperly on the Sale of a**
3 **Non-Performing Product**

4 13. Starting in November 2001, Fitzpatrick caused Liberate to fraudulently recognize a
5 total of \$2.6 million in revenue on a set of related contracts with Broadband Solutions, Inc.
6 ("BSI"), a cable company doing business in South Korea. Revenue recognition was improper
7 because the software that Liberate delivered to BSI under these contracts was inadequate to meet
8 the customer's needs. Fitzpatrick knew or was reckless in not knowing that the software was
9 inadequate to meet BSI's needs, but concealed this information from Liberate's finance
10 personnel.

11 14. In March 2001, Liberate and BSI entered into a license agreement. The agreement
12 called for Liberate to provide software that BSI could use to display Korean language print on
13 television screens. As Fitzpatrick knew, BSI ultimately intended to deploy the software
14 throughout an entire cable network.

15 15. As of March 2001, Liberate was developing but did not have a product capable of
16 displaying Korean language print and supporting an entire cable network. Because Liberate did
17 not have a functioning product, the Company did not ship any software to BSI in March 2001 and
18 did not recognize revenue on the license agreement at that time.

19 16. Also during 2001, Liberate entered into another agreement with BSI to develop a
20 digital cable network and integrate Liberate's software into the network.

21 17. By November 2001, Liberate had developed a product that was minimally able to
22 display Korean language print on a television in a laboratory setting. However, as Fitzpatrick
23 knew or was reckless in not knowing, the software was not suitable for deployment because it
24 was not capable of supporting an entire cable network. Despite this, in November 2001,
25 Fitzpatrick caused Liberate to ship the software to BSI.

26 18. In or about November 2001, Fitzpatrick told both BSI and Liberate finance personnel
27 that the software the Company had shipped was suitable for deployment with, at most, minor
28 alterations. This statement was false, and Fitzpatrick had no reasonable basis for it.

1 19. As a result of Fitzpatrick's fraudulent conduct, Liberate improperly recognized
2 software license revenue and related billings for system integration work totaling \$1.7 million for
3 its second quarter of fiscal 2002, ended November 30, 2001; \$787,566 for its third quarter of
4 fiscal 2002, ended February 28, 2001; and \$75,000 for its fourth quarter of fiscal 2002, ended
5 May 31, 2002.

6 20. Under Liberate's internal revenue recognition policy and generally accepted
7 accounting principles ("GAAP"), it was improper for Liberate to recognize revenue in these
8 quarters under its contracts with BSI because the Company had not delivered a product that was
9 adequate to meet BSI's needs. Fitzpatrick knew or was reckless in not knowing that revenue
10 recognition was improper.

11 **B. Fitzpatrick and Stitt Caused Liberate to Recognize Revenue Improperly on a
12 Round-Trip Sale**

13 21. In May 2002, Fitzpatrick and Stitt caused Liberate to enter into an agreement to
14 license its software to Mod Studios, Inc. ("Mod") for \$543,750.

15 22. Unlike most Liberate customers, Mod was not a large cable or telecommunications
16 network operator, but rather a small video production company, and it did not have the ability to
17 pay for the software license from Liberate. As a result, two people related to Mod obtained a
18 bank instrument called a letter of credit, which was used to guarantee payment under the license
19 agreement. Although Mod did not pay any cash at the time, based on the existence of the letter of
20 credit Liberate's finance department recognized the full amount of the license, or \$543,750, as
21 revenue for the fourth quarter of its fiscal year 2002, which ended May 31, 2002.

22 23. The license agreement with Mod was a sham. Unbeknownst to Liberate's finance
23 personnel, Mod did not intend to use its own funds, or the letter of credit, to pay for the license.
24 Instead, Fitzpatrick and Stitt arranged a complex transaction in which Liberate, through two
25 intermediary companies, secretly provided the funds to pay for its own license—a so-called
26 "round-trip sale."

27 24. The round-trip sale was completed in July 2002, when Liberate finalized a contract
28 with a separate company, Signatures Network, Inc. ("Signatures"), which gave Liberate a license

1 to use certain music video clips and related material. Pursuant to this contract, on or about July
2 22, 2002 Liberate wired \$1.2 million to Signatures. Signatures retained \$280,000 and that same
3 day wired the balance, or \$920,000, to another company, E Street Studios. Of this amount, E
4 Street Studios retained \$230,000 and on or about July 23, 2002 gave the balance, or \$690,000, to
5 Mod. On or about July 24, 2002, Mod wired \$543,750 to Liberate to pay for the software license
6 the Company had previously sold it.

7 25. Under Liberate's internal revenue recognition policy and GAAP, it was improper for
8 Liberate to recognize revenue on the software license to Mod in the quarter ended May 31, 2002.
9 The transaction conferred no economic benefit on Liberate because it was part of a larger round-
10 trip sale in which Mod intended to use Liberate's own funds to pay for the Liberate software
11 license.

12 26. Fitzpatrick and Stitt knew or were reckless in not knowing that revenue recognition
13 was improper. Defendants knew, but failed to inform Liberate's finance personnel, that the
14 agreement with Mod was only part of a larger transaction in which Mod would use Liberate's
15 own funds to pay for the Liberate software license.

16 C. **Fitzpatrick and Stitt Caused Liberate to Recognize Revenue Improperly by
17 Providing False Information About Liberate's Progress on a Long-Term Project**

18 27. For the quarter ended August 31, 2002, Liberate recognized \$615,526 of revenue on a
19 long-term service contract with @NetHome, a Japanese company. Liberate accounted for the
20 contract under the percentage-of-completion method, which allowed the Company to recognize
21 revenue each quarter based on how much work it had performed on the contract and how much
22 remained to be done. Revenue recognition in the quarter ended August 31, 2002 was improper
23 because Fitzpatrick and Stitt misled Liberate's finance department concerning the amount of
24 work remaining on the contract.

25 28. As part of its acquisition of another company in August 2002, Liberate assumed
26 responsibility for a long-term service contract with @NetHome. In or about the week of August
27 12, 2002, Fitzpatrick directed Stitt to determine the extent of work remaining on the contract so
28 that they could provide this information to Liberate's finance department. Fitzpatrick and Stitt

1 knew that Liberate's finance department would rely on the information they provided in
2 determining how much, if any, revenue Liberate could recognize on the contract for the August
3 31 quarter.

4 29. As Stitt began to investigate, he received incomplete and contradictory information
5 about the amount of work remaining to be done. Stitt communicated this fact to Fitzpatrick
6 during August 2002.

7 30. Despite this, in late August 2002 Fitzpatrick and Stitt told Liberate finance personnel
8 that the contract was substantially complete and that only minor work remained. There was no
9 reasonable basis for defendants' representation. Both Fitzpatrick and Stitt knew or were reckless
10 in not knowing that they did not have sufficient information about the contract to determine that
11 only minor work remained to be done.

12 31. In fact, as Liberate later concluded, the amount of work remaining on the contract was
13 substantial, and would require hundreds of man-hours to complete.

14 32. Under Liberate's internal revenue recognition policy and GAAP, it was improper for
15 Liberate to recognize revenue on the @NetHome contract for the quarter ended August 31, 2002
16 because the Company still had substantial work to do on the contract. Fitzpatrick and Stitt knew
17 or were reckless in not knowing that revenue recognition was improper.

18 **D. Fitzpatrick Caused Liberate to Recognize Revenue Improperly on a Transaction
19 in Which He Granted a Customer Secret Price Concessions**

20 33. On or about August 30, 2002, Fitzpatrick sent an electronic mail ("email") to an
21 official at Telewest Communications ("Telewest"), a British cable company that was one of
22 Liberate's largest customers. In the email, Fitzpatrick granted Telewest discounts on support and
23 professional services under an existing long-term contract with Liberate. Fitzpatrick granted the
24 concessions, which would reduce the amount of revenue Liberate could recognize under the
25 contract by \$1.2 million, without informing Liberate's finance personnel.

26 34. As a result of Fitzpatrick's conduct, Liberate improperly recognized \$1.2 million in
27 revenue under its contract with Telewest. Most of this revenue, or approximately \$900,000, was
28 recognized in Liberate's first quarter of fiscal 2003, ended August 31, 2002.

1 35. Under Liberate's internal revenue recognition policy and GAAP, it was improper for
2 Liberate to recognize this revenue on the Telewest contract because of price concessions that
3 required Liberate to provide discounted or free services. Fitzpatrick knew or was reckless in not
4 knowing that revenue recognition was improper.

5 **II. Defendants' Misrepresentations and Omissions to Auditors**

6 **A. Fitzpatrick's False Statements and Omissions Concerning an Unauthorized
7 Purchase Order**

8 36. On or about September 4, 2002, without informing Liberate's finance personnel, a
9 Liberate employee based in Britain entered into an agreement (a "purchase order") that obligated
10 the Company to purchase \$1.3 million in services from Global Interactive Technology ("GiT"), a
11 subsidiary of a Liberate customer called Global Business Solutions.

12 37. In mid-September 2002, Liberate finance personnel heard a rumor that such a
13 purchase order had been issued. On or about September 18, 2002, Liberate's then-Chief
14 Financial Officer ("CFO") asked Fitzpatrick to speak with the employee in Britain to determine
15 whether the employee had, in fact, issued the purchase order.

16 38. On or about September 19, 2002, Fitzpatrick spoke on a telephone call with the
17 Liberate employee in Britain and Liberate's then-Vice President of Sales for the Europe, Middle
18 East and Africa Region. During this call, the Liberate employee confirmed that he had issued a
19 \$1.3 million purchase order. Upon learning this, Fitzpatrick instructed the others on the call not
20 to reveal the existence of the purchase order to Liberate's finance personnel. In addition,
21 Fitzpatrick falsely reported back to Liberate's then-CFO that no such purchase order had been
22 issued.

23 39. Also on or about September 19, 2002, Fitzpatrick signed a letter to Liberate's
24 independent auditors (a "management representation letter"). Fitzpatrick back-dated the letter to
25 September 18, 2002. In the letter, Fitzpatrick represented, among other things, that he had
26 informed Liberate finance personnel of all agreements with Liberate customers to purchase goods
27 or services, and that he was not aware of any matters or occurrences that would materially affect

1 the recognition of revenue in Liberate's financial statements for the year. As Fitzpatrick knew,
2 these representations were false because he had falsely denied the existence of the \$1.3 million
3 purchase order to Liberate finance personnel, which would offset and reduce the revenue that
4 Liberate could recognize on its contract with GiT's parent company.

5 **B. Defendants' Other Misrepresentations and Omissions to Auditors**

6 40. In connection with Liberate's audit for the fiscal year May 31, 2002, defendants each
7 signed a management representation letter to the Company's independent auditors. Stitt dated his
8 letter June 11, 2002. Fitzpatrick's letter was dated August 5, 2002.

9 41. In their respective letters, each defendant represented that, among other things, he was
10 not aware of any matters or occurrences that would materially affect the recognition of revenue in
11 Liberate's financial statements for the year. For the reasons alleged herein, Fitzpatrick and Stitt
12 knew that this representation was false.

13 42. In connection with a review of Liberate's financial results for the first quarter of its
14 fiscal year 2003, ended August 31, 2002, defendants again each signed a management
15 representation letter to the Company's independent auditors. Stitt dated his letter September 1,
16 2002. As alleged above, Fitzpatrick dated his letter September 18, 2002.

17 43. In their respective letters, each defendant represented that, among other things, he was
18 not aware of any matters or occurrences that would materially affect the recognition of revenue in
19 Liberate's financial statements for the year. For the reasons alleged herein, Fitzpatrick and Stitt
20 knew that this representation was false.

21 **III. As a Result of Defendants' Fraud, Liberate Reported False Financial Results**

22 44. During the course of defendants' fraud, Liberate filed with the Commission the
23 following periodic reports: (a) on or about January 14, 2002, Liberate filed a Form 10-Q for the
24 second quarter of fiscal year 2002, which ended November 30, 2001; (b) on or about April 12,
25 2002, Liberate filed a Form 10-Q for the third quarter of fiscal year 2002, which ended February
26 28, 2002; and (c) on or about August 8, 2002, Liberate filed a Form 10-K for fiscal year 2002,
27 which ended May 31, 2002.

45. The Company did not file a Form 10-Q for the first quarter of its fiscal year 2003, which ended August 31, 2002. However, on or about September 26, 2002, Liberate issued a press release announcing its financial results for that quarter to the public, and held an earnings release conference call in which Fitzpatrick participated.

46. In addition, on or about July 2, 2002 Liberate filed with the Commission a Form S-8 that registered shares for an employee benefits plan. The Form S-8 incorporated by reference all of the quarterly reports that Liberate had previously filed relating to its fiscal year 2002, and also all of the subsequently filed financial statements during the course of defendants' fraud.

47. As a result of defendants' conduct, each of these Form 10-Qs, the Form 10-K, the press release and the Form S-8 contained false financial results that materially overstated Liberate's revenue for the respective periods.

48. Liberate subsequently announced that it would restate its financial results for the second and third quarters of fiscal 2002 and for the entire fiscal year, and also for the first quarter of fiscal 2003. As part of the restatement, Liberate reversed or delayed revenue recognition on each of the transactions described herein.

FIRST CLAIM FOR RELIEF

(Violations of Section 17(a) of the Securities Act by Fitzpatrick)

49. The Commission realleges and incorporates by this reference Paragraphs 1 through 48,
above

50. By engaging in the conduct described above, Fitzpatrick, directly or indirectly, in the offer or sale of securities, by use of the means or instruments of transportation or communication in interstate commerce or by use of the mails:

- (a) employed devices, schemes, or artifices to defraud;
- (b) obtained money or property by means of untrue statements of material fact or by omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and

(c) engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon the purchasers.

51. By reason of the foregoing, Fitzpatrick violated, and unless restrained and enjoined, will continue to commit violations of, Section 17(a) of the Securities Act [15 U.S.C. § 77q(a)].

SECOND CLAIM FOR RELIEF

(Violations of Section 10(b) of the Exchange Act and Rule 10b-5 Thereunder by Fitzpatrick and Stitt).

52. The Commission realleges and incorporates by this reference Paragraphs 1 through 48, above.

53. By engaging in the conduct described above, Liberale, Fitzpatrick and Stitt, directly or indirectly, in connection with the purchase or sale of securities, by the use of means or instrumentalities of interstate commerce, or the mails:

- (a) employed devices, schemes, or artifices to defraud;
- (b) made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and
- (c) engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons, including purchasers and sellers of securities.

54. By reason of the foregoing, Fitzpatrick and Stitt violated Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5].

55. Fitzpatrick and Stitt also knowingly provided substantial assistance to Liberate's violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5], and therefore are liable as aiders and abettors pursuant to Section 20(e) of the Exchange Act [15 U.S.C. § 78t(e)].

56. Unless restrained and enjoined, Fitzpatrick and Stitt will continue to violated and aid and abet violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 [17 C.F.R. § 240.10b-5].

THIRD CLAIM FOR RELIEF

*(False Statements and Omissions to Accountants and Auditors—
Violation of Rule 13b2-2 by Fitzpatrick and Stitt)*

57. The Commission realleges and incorporates by this reference Paragraphs 1 through 48, above.

58. By engaging in the acts and conduct alleged above, Fitzpatrick and Stitt, directly or indirectly, made or caused to be made a materially false or misleading statements or omitted to state or caused another person to omit to state, material facts necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to an accountant in connection with an audit or examination of the financial statements of Liberate required to be made or the preparation or filing of reports required to be filed by Liberate with the Commission.

59. By reason of the foregoing, Fitzpatrick and Stitt violated and, unless restrained and enjoined, will continue to violate Rule 13b2-2 [17 C.F.R. § 240.13b2-2].

FOURTH CLAIM FOR RELIEF

(False Periodic Reports—Aiding and Abetting Violations of Section 13(a) of the Exchange Act And Rules 12b-20, 13a-1, and 13a-13 Thereunder by Stitt)

60. The Commission realleges and incorporates by this reference Paragraphs 1 through 48, above.

61. Based on the conduct alleged above, Liberate violated Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1, and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1 and 240.13a-13], which obligate issuers of securities registered pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l] to file with the Commission accurate quarterly and annual reports.

62. By engaging in the conduct alleged above, Stitt knowingly provided substantial assistance to Liberate's filing of materially false and misleading quarterly and annual reports with the Commission.

63. By reason of the foregoing, Stitt has aided and abetted violations by Liberate of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1, and 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1 and 240.13a-13] and therefore is liable as an aider and abettor pursuant to Section 20(e) of the Exchange Act [15 U.S.C. § 78t(e)]. Unless restrained and enjoined, Stitt will continue to aid and abet such violations.

FIFTH CLAIM FOR RELIEF

(Inaccurate Books and Records—Aiding and Abetting Violations of Section 13(b)(2)(A) of the Exchange Act by Stitt)

64. The Commission realleges and incorporates by this reference Paragraphs 1 through 48, above.

65. Based on the conduct alleged above, Liberate violated Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)], which obligates issuers of securities registered pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l] to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer.

66. By engaging in the conduct alleged above, Stitt knowingly provided substantial assistance to Liberate's failure to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect its transactions and dispositions of its assets.

67. By reason of the foregoing, Stitt has aided and abetted violations by Liberate of Section 13(b)(2)(A) of the Exchange Act [15 U.S.C. § 78m(b)(2)(A)] and therefore is liable as an aider and abettor pursuant to Section 20(e) of the Exchange Act [15 U.S.C. § 78t(e)]. Unless restrained and enjoined, Stitt will continue to aid and abet such violations.

SIXTH CLAIM FOR RELIEF

(Inadequate Internal Accounting Controls—Aiding and Abetting Violations of Section 13(b)(2)(B) of the Exchange Act by Stitt)

68. The Commission realleges and incorporates by this reference Paragraphs 1 through 48, above.

69. Based on the conduct alleged above, Liberate violated Section 13(b)(2)(B) of the Exchange Act [15 U.S.C. § 78m(b)(2)(B)], which obligates issuers of securities registered

1 pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l] to devise and maintain a sufficient
2 system of internal accounting controls.

3 70. By engaging in the conduct alleged above, Stitt knowingly provided substantial
4 assistance to Liberete's failure to devise and maintain a sufficient system of internal accounting
5 controls.

6 71. By reason of the foregoing, Stitt has aided and abetted violations by Liberete of
7 Section 13(b)(2)(B) of the Exchange Act [15 U.S.C. § 78m(b)(2)(B)] and therefore is liable as an
8 aider and abettor pursuant to Section 20(e) of the Exchange Act [15 U.S.C. § 78t(e)]. Unless
9 restrained and enjoined, Stitt will continue to aid and abet such violations.

10 **SEVENTH CLAIM FOR RELIEF**

11 *(Circumventing Internal Accounting Controls—Violations of
Section 13(b)(5) of the Exchange Act and Rule 13b2-1 by Stitt)*

12 72. The Commission realleges and incorporates by this reference Paragraphs 1 through 48,
13 above.

14 73. By his conduct alleged above, Stitt has violated Section 13(b)(5) of the Exchange Act
15 [15 U.S.C. 78m(b)(5)] and Rule 13b2-1 thereunder [17 C.F.R. § 240.13b2-1] which prohibit
16 anyone from knowingly circumventing a system of internal accounting, or knowingly falsifying
17 certain books, records, and accounts.

18 74. Unless restrained and enjoined, Stitt will continue to violate Section 13(b)(5) of the
19 Exchange Act [15 U.S.C. § 78m(b)(5)], and Rule 13b2-1 thereunder [17 C.F.R. § 240.13b2-1].

20 **PRAYER FOR RELIEF**

21 WHEREFORE, the Commission respectfully requests that this Court:

22 I.

23 Permanently enjoin Fitzpatrick from directly or indirectly violating Section 17(a) of the
24 Securities Act, and from violating or aiding and abetting violations of Section 10(b) of the Exchange
25 Act and Rules 10b-5 and 13b2-2 thereunder;

1 II.

2 Enjoin Fitzpatrick from serving as an officer or director of any entity having a class of
3 securities registered with the Commission pursuant to Section 12 of the Exchange Act [15 U.S.C. §
4 78l] or that is required to file reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. §
5 78o(d)];

6 III.

7 Order Fitzpatrick to pay civil penalties pursuant to Section 20(d) of the Securities Act [15
8 U.S.C. § 77t(d)] and Section 21(d) of the Exchange Act [15 U.S.C. § 78u(d)].

9 IV.

10 Permanently enjoin Stitt from directly or indirectly violating Section 13(b)(5) of the Exchange
11 Act and Rule 13b2-1 thereunder, and from violating or aiding and abetting violations of Sections
12 10(b), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Rules 10b-5, 12b-20, 13a-1, 13a-13 and
13 13b2-2 thereunder.

14 V.

15 Enjoin Stitt from serving as an officer or director of any entity having a class of securities
16 registered with the Commission pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l] or that
17 is required to file reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. § 78o(d)];

18 VI.

19 Order Stitt to pay civil penalties pursuant to Section 21(d) of the Exchange Act [15 U.S.C. §
20 78u(d)].

21 VII.

22 Order Fitzpatrick and Stitt to disgorge all benefits they obtained wrongfully as a result of their
23 violations of the federal securities laws alleged in this Complaint, including prejudgment interest.

24 VIII.

25 Retain jurisdiction of this action in accordance with the principles of equity and the Federal
26 Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that
27 may be entered, or to entertain any suitable application or motion for additional relief within the
28 jurisdiction of this Court.

IX.

Grant such other and further relief as this Court may determine to be just and necessary.

DATED: September 30, 2004

Respectfully submitted,

Helane L. Morrison
Robert L. Mitchell
Michael S. Dicke
Craig M. Hughes

Attorneys for Plaintiff
SECURITIES AND EXCHANGE COMMISSION